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DEPT FOR EUR/NE - PEACOCK
TREASURY FOR ASST. SEC. CHAPOTON AND ASST. SEC. MEAGHER
E.O. 12356: DECL:OADR
TAGS: PREL, BD
SUBJ: BERMUDA TAX TREATY RESERVATIONS - LETTER FROM PREMIER SWAN
TO SECRETARY SHULTZ

1. THE GOVERNMENT OF BERMUDA (GOB) HAS BEEN STUDYING THE IMPLICATIONS OF THE PROPOSED RESERVATIONS TO THE US/BERMUDA TAX TREATY. THEY HAVE RESPONDED THAT THE RESERVATIONS ARE ACCEPTABLE IF TWO CONDITIONS ARE MET: (1) THE ADMINISTRATION IS SUCCESSFUL IN ADDING A "DOMESTIC ELECTION" (ALONG THE LINES OF SENATOR PACKWOOD'S PROPOSAL) TO THE TECHNICAL CORRECTIONS BILL PENDING BEFORE THE U.S. SENATE; AND (2) PUBLIC REFERENCE IS MADE TO THE ADMINISTRATIONS INTENT TO OPEN NEGOTIATIONS WITH THE GOVERNMENT OF BARBADOS REGARDING THE DELETION OF THE EXCISE TAX EXEMPTION CONTAINED IN THE US/BARBADOS TAX TREATY. COMMENT: BOTH POINTS ARE CONSISTENT WITH THE GOB'S LONG-STANDING POSTURE ON RATIFICATION OF THE US/BERMUDA TAX TREATY. POST DOES NOT FEEL A RESPONSE TO THE LETTER IS NECESSARY PENDING CONGRESSIONAL ACTION THE NEXT FEW WEEKS.

2. TEXT OF LETTER FOLLOWS:

BEGIN TEXT: DEAR SECRETARY SHULTZ:

I HAVE BEEN COPIED SENATOR PELL'S LETTER OF AUGUST 11TH, 1988 TO MEMBERS OF THE U.S. SENATE COMMITTEE ON FOREIGN RELATIONS. THIS INCLUDED THE PROPOSED TEXT OF RESERVATIONS TO BE INCORPORATED IN THE RESOLUTION OF RATIFICATION OF THE US/BERMUDA TAX TREATY.

WHILE THE BERMUDA GOVERNMENT WISHES THE TREATY TO BE RATIFIED THERE ARE TWO OUTSTANDING CONCERNS WHICH ARE HIGHLIGHTED BY THESE RESERVATIONS.

FIRST, THE RESERVATIONS WITH RESPECT TO THE EXCISE TAX PROVISION AFFECTING U.S. OWNED, BERMUDA BASED INSURANCE COMPANIES. THESE HAVE THE LONG RANGE EFFECT OF ELIMINATING PARITY IN THE U.S. TAX TREATMENT WHICH OUR GOVERNMENT SEEKS AND HAS SOUGHT FOR BERMUDA BASED INSURANCE COMPANIES WHEN COMPARING BERMUDA SITUS INCORPORATION WITH U.S. (DOMESTIC) INCORPORATION. (SEE MY LETTER TO ROGER MENTZ, ASSISTANT SECRETARY, TAX POLICY DATED JUNE 26TH 1987 AND ATTACHMENTS THERETO.)

AS YOU ARE AWARE, THE U.S. TREASURY DEPARTMENT, ALONG WITH PRIVATE EFFORTS OF THE BERMUDA INSURANCE SECTOR OF OUR ECONOMY, HAS BEEN SEEKING AN AMENDMENT IN THE TECHNICAL CORRECTIONS BILL OF 1988 WHICH WOULD PROVIDE A "DOMESTIC ELECTION" FOR U.S. OWNED BERMUDA BASED INSURERS TO BE TREATED AS U.S. INCORPORATED INSURERS AS OUTLINED IN THE ATTACHMENT.

IT IS OUR UNDERSTANDING THAT THE TREATY ITSELF IS A VITAL COMPONENT FOR SECURING AGREEMENT TO A DOMESTIC ELECTION AMENDMENT WHICH WOULD BE ACCEPTABLE TO BERMUDA. HOWEVER, WE DO NOT KNOW IF THE DOMESTIC ELECTION WILL BE ENACTED BY CONGRESS IN THE FORM AS OUTLINED IN THE ATTACHMENT AND THEREFORE DO NOT KNOW IF, OR HOW, THOSE COR-

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RECTIONS WILL AFFECT BERMUDA BASED INSURANCE COMPANIES.

SECOND, THE RESERVATIONS SET A DATE, 31ST DECEMBER, 1989 FOR THE EXPIRATION OF EXEMPTION FROM FEDERAL EXCISE TAX. WE UNDERSTAND THAT THE US/BARBADOS TREATY WILL BE SIMILARLY AMENDED AT THAT TIME. WHILE WE APPRECIATE WHY THERE CANNOT BE EXPLICIT LINKAGE, WE WOULD BE REASSURED IF THE SENATE COMMITTEE REPORT ACKNOWLEDGED THIS UNDERSTANDING.

THE BERMUDA GOVERNMENT'S POSITION IS THAT ANY ACTION ON THE TREATY CANNOT BE VIEWED IN ISOLATION FROM THESE RELATED ISSUES. IF THE TECHNICAL CORRECTION CONCERNING THE DOMESTIC ELECTION IS NOT ADOPTED, OR IS INEFFECTIVE FROM OUR PERSPECTIVE, OR IF THE U.S. ADMINISTRATION'S COMMITMENT TO RENEGOTIATE OUR RELATIVE DISADVANTAGE UNDER THE BARBADOS TREATY IS NOT PUBLICLY ADDRESSED, THEN THE BERMUDA GOVERNMENT WOULD FIND IT DIFFICULT TO JUSTIFY RATIFICATION OF THE TREATY.

ALTHOUGH THESE CONCERNS HAVE BEEN EXPRESSED ON MANY OCCASIONS BEFORE, I THINK IT IMPORTANT THAT ALL PARTIES BE MADE AWARE THAT BERMUDA'S ACCEPTANCE OF THE TREATY, WITH THE RESERVATIONS BEING PROPOSED IN THE SENATE FOREIGN RELATIONS COMMITTEE, CAN ONLY BE WITH THESE CAVEATS. YOURS SINCERELY, JOHN W. SWAN
END TEXT OF LETTER.

BEGIN TEXT OF ATTACHMENT:

PROPOSED AMENDMENT TO THE TECHNICAL CORRECTIONS BILL RE "DOMESTIC ELECTION"

THE PRINCIPAL FEATURES OF THE SO-CALLED "DOMESTIC ELECTION" AMENDMENT AFFECTING OFFSHORE INSURANCE COMPANIES ARE THE FOLLOWING.

- 1. AN INSURANCE COMPANY INCORPORATED IN A FOREIGN JURISDICTION (E.G. BERMUDA) WOULD BE ALLOWED TO ELECT TO BE TAXED IN ALL RESPECTS JUST AS IF IT WERE A U.S. CORPORATION. IF IT MAKES THE ELECTION, IT WILL PAY A REGULAR U.S. CORPORATE INCOME TAX (34 PERCENT) ON ITS ANNUAL PROFITS, AND ITS SHAREHOLDERS WILL BE TAXED ON DIVIDENDS ACTUALLY PAID TO THEM IN THE SAME MANNER THAT SHAREHOLDERS OF REGULAR U.S. CORPORATIONS ARE TAXED ON DIVIDENDS RECEIVED.
- 2. U.S. EXCISE TAX WOULD NOT BE IMPOSED ON PREMIUMS PAID TO OFFSHORE COMPANIES MAKING THE "DOMESTIC ELECTION."
- 3. SHAREHOLDERS WOULD NOT BE TAXED CURRENTLY ON THE COMPANY'S PROFITS UNDER SUB-PART F BUT WOULD RECEIVE THE SAME TREATMENT AS UNDER CURRENT LAW FOR FOREIGN TAX CREDIT PURPOSES WITH RESPECT TO THE ELECTING COMPANY'S INCOME.
- 4. LOSSES COULD BE CARRIED FORWARD AND BACKWARD UNDER REGULAR U.S. RULES BUT ONLY AGAINST THE INCOME OF THE ELECTING COMPANY
- 5. EARNINGS AND PROFITS OF THE ELECTING FOREIGN COMPANY ACCUMULATED PRIOR TO MAKING THE ELECTION WOULD NOT BE TAXED IMMEDIATELY AS A RESULT OF MAKING THE ELECTION. AN ORDERING RULE WOULD PROVIDE THAT PRE-ELECTION ACCUMULATED EARNINGS WOULD BE DISTRIBUTED (AND TAXED TO THE RECIPIENT) SUBSEQUENT TO DISTRIBUTIONS OF EARNINGS AND PROFITS ACCUMULATED DURING YEARS WHEN THE ELECTION IS IN EFFECT.
- 6. A TOLL CHARGE OF 1/2 OF 1 PERCENT OF CAPITAL AND SURPLUS FOR EXISTING COMPANIES NOT TO EXCEED DOLS 1,000,000 FOR AN ELECTING COMPANY WOULD BE ACCEPTABLE IF IT IS NECESSARY TO PAY FOR THE PROVISION.

END OF TEXT OF ATTACHMENT.

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END OF MESSAGE

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